

ICC Docket No. 04-0779
ICC Staff Exhibit 19.0

Staff Group Cross Exhibit- MUDRA
Company Response to Staff Data Requests:
MGM 6.04, 6.06, 6.08, 6.09, 6.10, 6.13, 6.15, 7.01

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I.C.C. DOCKET NO. 04-0779

Staff Exhibit No. 19.0

Witness _____

Date 5/19/05 Reporter C

**Northern Illinois Gas Company
d/b/a Nicor Gas Company
Response to:
Illinois Commerce Commission
Ill.C.C. Docket No. 04-0779
MGM Sixth Data Request**

MGM 6.04 Q. Does the Company agree that Nicor Gas has included assets in its rate base that are not long-term assets?

MGM 6.04 A. Assuming Mr. McNally is referring to the GAAP definition of a long-term asset, there are some current assets included in and current liabilities deducted from rate base.

Witness(es) who can testify subject to appropriate, in-scope cross examination:
Robert Mudra

**Northern Illinois Gas Company
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MGM 6.06 Q. Please provide monthly balances for the Customer Deposits, Budget Plan Balance, and Customer Advances for Construction accounts, as shown on Nicor Gas Exhibit 20B.8, for 2003-2005.

MGM 6.06 A. Please refer to the attached Exhibit 1.

Witness(es) who can testify subject to appropriate, in-scope cross examination:
Robert Mudra

Monthly Balances Provided in Response to Data Request MGM 6.06

Year	Month	Budget Payment Plan Month-end Balance	Customer Deposits	Customer Advances for Construction
2003	Jan	\$ 66,433	\$ 13,095	\$ 4,069
2003	Feb	\$ 22,993	\$ 14,742	\$ 4,098
2003	Mar	\$ (20,350)	\$ 15,680	\$ 4,083
2003	Apr	\$ (39,825)	\$ 16,586	\$ 4,092
2003	May	\$ (32,035)	\$ 17,660	\$ 4,147
2003	Jun	\$ (9,182)	\$ 18,636	\$ 4,179
2003	Jul	\$ 16,591	\$ 19,569	\$ 4,183
2003	Aug	\$ 42,481	\$ 20,276	\$ 4,223
2003	Sep	\$ 73,608	\$ 20,799	\$ 4,294
2003	Oct	\$ 100,935	\$ 21,337	\$ 4,378
2003	Nov	\$ 120,603	\$ 22,696	\$ 4,385
2003	Dec	\$ 119,180	\$ 23,711	\$ 4,027
2004	Jan	\$ 92,775	\$ 23,637	\$ 4,029
2004	Feb	\$ 48,024	\$ 23,502	\$ 4,030
2004	Mar	\$ 20,391	\$ 23,339	\$ 3,975
2004	Apr	\$ 14,855	\$ 16,586	\$ 4,222
2004	May	\$ (13,154)	\$ 17,660	\$ 4,197
2004	Jun	\$ 2,639	\$ 18,636	\$ 4,172
2004	Jul	\$ 26,060	\$ 19,569	\$ 4,147
2004	Aug	\$ 52,928	\$ 20,276	\$ 4,123
2004	Sep	\$ 82,086	\$ 20,799	\$ 4,098
2004	Oct	\$ 103,120	\$ 21,337	\$ 4,073
2004	Nov	\$ 117,140	\$ 22,696	\$ 4,048
2004	Dec	\$ 112,986	\$ 23,711	\$ 4,023
2005	Jan	\$ 91,021	\$ 23,637	\$ 4,023
2005	Feb	\$ 57,128	\$ 23,502	\$ 4,022
2005	Mar	\$ 29,565	\$ 23,339	\$ 4,022
2005	Apr	\$ 18,038	\$ 16,586	\$ 4,022
2005	May	\$ (13,154)	\$ 17,660	\$ 4,021
2005	Jun	\$ 2,639	\$ 18,636	\$ 4,021
2005	Jul	\$ 26,060	\$ 19,569	\$ 4,021
2005	Aug	\$ 52,928	\$ 20,276	\$ 4,020
2005	Sep	\$ 82,086	\$ 20,799	\$ 4,020
2005	Oct	\$ 103,120	\$ 21,337	\$ 4,020
2005	Nov	\$ 117,140	\$ 22,696	\$ 4,019
2005	Dec	\$ 112,986	\$ 23,711	\$ 4,019

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MGM 6.08 Q. Cite the accounting rule(s) that require Nicor Gas to write off recovered common stock flotation costs. Include with those citations complete and accurate quotations from the rules cited that explicitly require Nicor Gas to write off recovered common stock flotation costs as well as the year(s) the rules were implemented.

MGM 6.08 A. The Illinois Commerce Commission's Uniform System of Accounts includes as Note B of its description of Account 214, Capital Stock Expense, the following requirement (emphasis added):

The utility may write off capital stock expense in whole or in part by charges to account 211, Miscellaneous Paid-In Capital. The utility may elect to delay amortization of common stock expenses until the Commission determines the recoverability of such expenses through rates. In any case, only those common stock expenses which remain unrecovered through rates shall be recorded in this account. **Common stock expenses, which have been recovered through rates, shall be amortized to account 211, Miscellaneous Paid-In Capital.** This procedure may be followed for existing capital stock expenses which have not been recovered through rates as of December 31, 1993.

Witness(es) who can testify subject to appropriate, in-scope cross examination:
Robert Mudra

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MGM 6.09 Q. Please answer the following questions separately for both Messrs. Hawley and Mudra.

- A. Identify the positions that Messrs. Hawley and Mudra held at Nicor Gas at the time of each of the common stock issuances listed on Exhibit 20B.6. Include a description of their job responsibilities and whether they were directly involved in either the issuance of common stock or Nicor Gas' recording of common stock flotation costs.
- B. Provide the date on which Messrs. Hawley and Mudra became directly responsible for the manner in which Nicor Gas tracks and records the recovery of financial stock flotation costs.

MGM 6.09 A. A. Messrs. Hawley and Mudra were not employees of Nicor Gas at the time of the common stock issuances listed on Exhibit 20B.6.

B. Mr. Hawley joined Nicor Gas as executive vice president and chief financial officer on December 8, 2003. At that time, he assumed executive responsibility for the manner in which Nicor Gas tracks and records the recovery of common stock flotation costs.

Mr. Mudra is not directly responsible for the manner in which Nicor Gas tracks and records the recovery of common stock flotation costs.

Witness(es) who can testify subject to appropriate, in-scope cross examination:
Richard Hawley and Robert Mudra

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- MGM 6.10 Q. Identify the date on which Nicor Gas' recording of the common stock flotation costs listed on Exhibit 20B.6 was last audited by Nicor Gas' independent auditors. Provide a copy of the independent auditors' work papers pertaining to those costs.
- MGM 6.10 A. Nicor Gas' most recent annual financial statements (for the year ended December 31, 2004) were audited by Deloitte & Touche LLP, who issued their opinion on February 28, 2005. Common stock flotation costs last changed in 1973 and the relevant work papers of the independent auditor at that time (a firm other than our current independent auditor) pertaining to these costs are no longer believed to exist.

Witness(es) who can testify subject to appropriate, in-scope cross examination:
Robert Mudra

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- MGM 6.13 Q. The proposed capital structure presented on Nicor Gas Exhibit 20B.1 includes approximately \$1.15 billion of capital. Nicor Gas Exhibit 26.1 identifies approximately \$1.44 billion in rate base assets. Please identify the source of funds for the approximately \$300 million of rate base over and above the total capital in Nicor Gas' proposed capital structure.
- MGM 6.13 A. In Illinois and in other jurisdictions, utility rate base (a regulatory construct) and capitalization have not historically been equal (*see, e.g.*, the comments of the Commission in Docket No. 87-0032 regarding reconciliation between rate base and capitalization) and, in particular, rate base is often greater than capitalization. This is why return is multiplied by the rate base instead of the capital structure itself. Nicor Gas' rate base assets are financed by the long-term permanent capital structure of the firm including long-term debt, preferred stock, and common equity.

Witness(es) who can testify subject to appropriate, in-scope cross examination:
Richard Hawley

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- MGM 6.15 Q. Is Nicor Gas prohibited from paying its debt service obligations to short-term debt investors from cash flows generated by use of rate base assets? If so, please provide copies of any legal documents that support that conclusion.
- MGM 6.15 A. It is unclear what "cash flows generated by use of rate base assets" refers to; however, as is typical, Nicor Gas' unsecured commercial paper issuance agreements bear no limitations on the sources of cash flows from which debt service obligations should be paid.

Witness(es) who can testify subject to appropriate, in-scope cross examination:
Robert Mudra

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MGM 7.01 Q. Please provide a copy of the most recent research summary report for Nicor Gas published by Standard & Poor's.

MGM 7.01 A. Please see attached Exhibit A, which includes the most recent Standard & Poor's research report summary, published on April 20, 2005.

Witness(es) who can testify subject to appropriate, in-scope cross examination:
Robert Mudra

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**Most Recent Standard & Poor's Research Report Summary
Provided in Response to MGM 7.01**

**STANDARD
& POOR'S**

RATINGS DIRECT LINK

Research:

Summary:

Nicor Gas Co.

Publication date: 20-Apr -2005

Primary Credit Analyst(s): Barbara A Eiseman, New York (1) 212-438-7666;
barbara_eiseman@standardandpoors.com

Credit Rating: AA/Negative/A -1+

Rationale

The ratings on Nicor Gas Co. are based on the consolidated credit profile of the Nicor Inc. companies that include Nicor Gas' regulated operations, a containerized shipping business, and other smaller unregulated ventures that are energy related. Nicor Gas, a natural gas distribution utility and Nicor's primary subsidiary, accounts for about 85% of consolidated operating income. Because there are no regulatory mechanisms or other structural barriers in Illinois that sufficiently restrict access by the parent to the cash flow of the utility, Standard & Poor's views the default risk of Nicor Gas the same as Nicor.

Nicor's creditworthiness results from a strong business profile and declining, but still healthy, consolidated financial condition. The company's business position is supported by a large secure residential and commercial customer base, low costs and rates, a diverse supply portfolio, historically responsive ratemaking principles, solid operations, and favorable competitive standing. These strengths are tempered somewhat by Nicor's investment in higher-risk unregulated operations and uncertainties regarding investigations into alleged abuses of Nicor Gas' performance-based rate plan (PBR) and a possible civil injunctive action, both of which could result in financial penalties. These challenges are a concern for a company with such lofty ratings.

In Standard & Poor's view, the resolution of outstanding matters facing the company will have only a nominal effect, if any, on Nicor's currently strong financial parameters. However, rising operating

expenses with no prospects for rate relief until the fall of 2005, along with an unexpectedly severe financial penalty, may push key financial parameters out of an acceptable range for the mid 'AA' rating category.

On Nov. 4, 2004, Nicor Gas filed with the Illinois Commerce Commission (ICC) for an \$83 million (16.5%) rate hike which was subsequently revised to \$77 million. Rate relief is needed to recover capital investments made since 1996, as well as higher operating costs. Implementation of higher rates would help stem further financial erosion of the company's currently healthy financial condition, which is occurring because of rising operating expenses and the long-term absence of rate relief.

In 2002, Nicor uncovered accounting problems and losses related to its retail energy marketing joint venture, Nicor Energy (now discontinued), with Dynegy Inc. and possible improper behavior in its PBR. Following these announcements, shareholder class-action suits and securities class actions were brought against Nicor and certain executives. Although the securities class-action litigation and shareholder derivative action (pending court approval) were settled, Nicor has been informed by the SEC's Division of Enforcement that it intended to recommend to the SEC that it bring a civil injunctive action against the company. Meanwhile, parties to the ICC's proceedings, regarding allegations that Nicor Gas acted improperly along with the PBR plan, have agreed to a stay of the evidentiary hearings in order to undertake additional third party discovery from Entergy-Koch Trading L.P., with whom Nicor did business under the PBR. Therefore, timing of a final decision from the ICC is uncertain.

In response to the allegations, Nicor's board appointed a special independent committee that investigated the company's natural-gas purchases, sales, transportation, and storage activities. Although the report found no evidence of criminal conduct or fraud, a review of additional information and follow-up interviews of Nicor Gas employees indicated that certain personnel may have engaged in potentially fraudulent conduct regarding the PBR and possibly violated SEC rules. Nicor continues to cooperate with the SEC and U.S. Attorney's Office, but still asserts that no adjustment to its financial statements or customer refunds are required. The company terminated four employees in connection with this matter.

Consistent with the accounting and other inadvertent errors related to the PBR plan that were identified in the independent counsel's 2003 report, Nicor made certain adjustments to its financial statements that resulted in a \$24.8 million liability at the end of 2003. Included in the adjustments is a \$4.1 million loss contingency. A \$1.8 million adjustment to the previously recorded liability was made in the third quarter of 2004, increasing the recorded liability to \$26.6 million. In addition, Nicor Gas estimates that there is \$26.9 million owed to the company from the 2002 PBR, which was not recognized due to uncertainties surrounding the PBR.

Nicor's financial profile deteriorated in 2004, with funds from operations (FFO) interest coverage and FFO to total debt hovering around 6.6x and 26%, respectively, from about 10.5x and 41% in 2003. Notwithstanding the decline, the ratios still remain within the range acceptable for the 'AA' rating category. Total debt to capital stood at a liberal 58.4% as of Dec. 31, 2004 and 59.6% at the end of 2003. However, the bulk of Nicor Gas' debt is seasonal and is paid down as the winter heating season ends and revenues outpace expenses. Therefore, when year-end balances are adjusted for gas inventories, debt leverage remains appropriate for the rating. Cash flow after dividends is expected to cover the bulk of the company's capital program for the foreseeable future.

Customer growth should remain modest (about 1% to 2%), although throughput increases may lag due to more efficient household appliances and conservation. Much of this growth comes from new housing construction because natural gas has saturated most of the space-heating market. Over the long term, increased sales to summer-peaking electric generation facilities should help revenue growth and

improve the system load factor. Modest exposure to fuel switching and customer bypass exists. However, Nicor Gas can offer special tariffs and contracts to retain gas users with direct pipeline access. Gas costs are minimized and reliability is enhanced through diversity in supply contracts, suppliers, and production regions, and through abundant, company-owned gas storage facilities.

Short-term credit factors

Nicor and Nicor Gas have 'A -1+' short-term corporate credit and commercial paper ratings. Liquidity should remain adequate, despite the seasonal nature of the gas distribution business. Cash requirements typically increase over the third and fourth quarters, due to increases in natural gas purchases, gas in storage, and accounts receivable. Over the first and second quarters, positive cash flow generally occurs from the sale of gas in storage and the collection of accounts receivable. This cash is typically used to reduce short-term debt, which is incurred to purchase gas in anticipation of the winter heating season, to near zero during the second quarter.

Historically strong consolidated funds flow from operations declined significantly in 2004 due to a tax refund in 2003. The decline is expected to continue in 2005 owing to rising expenses, somewhat flat revenue growth, and absence of rate relief until late 2005. Nevertheless, Nicor should have ample capacity to internally fund dividends and the bulk of consolidated construction expenditures.

As of Dec. 31, 2004, Nicor had \$12.9 million of cash and cash equivalents. The company's revolving credit agreement, totaling \$500 million through September 2007 and a \$400 million 210-day seasonal revolver serve as backup for the issuance of commercial paper. At the end of December 2004, the company had \$490 million of commercial paper outstanding. The seasonal revolver expired on April 12, 2005. The company is evaluating alternatives to meet its seasonal financing needs for the 2005-2006 heating season.

To comply with the covenants in its credit agreements, total debt to capitalization cannot exceed 65% at the end of the first and second fiscal quarters, and the ratio cannot exceed 70% at the end of the third and fourth fiscal quarters. At the end of December 2004, Nicor was in compliance with these financial ratios. None of Nicor's bank agreements contains material adverse change clauses or rating triggers.

Under certain agreements, downgrades below investment grade could result in the Nicor companies having to post collateral. Standard & Poor's does not consider this a serious concern, given the 'AA' corporate credit ratings on Nicor and Nicor Gas. Nicor has no long-term debt and Nicor Gas has a very manageable maturity schedule with only \$50 million of debt due in 2006. Nicor Gas has \$75 million of capacity under a Rule 415 shelf registration covering senior secured debt transactions.

Outlook

The negative outlook on Nicor Gas mirrors that of parent Nicor and reflects the recent erosion of Nicor's currently healthy financial condition. Absent a supportive rate order in its pending rate case and/or an unexpectedly harsh financial penalty related to outstanding regulatory and legal issues, Nicor's financial profile may no longer support mid 'AA' ratings. The PBR issue may not be resolved prior to a rate case decision. Nevertheless, responsive rate treatment that would enable the company to produce FFO to total debt in the upper 20s percentage range would lead to ratings stability. In Standard & Poor's view, Nicor's financial profile could withstand a one-time financial penalty related to the PBR, unless the financial charge is surprisingly severe.